Venture Capital (VC) - Overview on Popular Source of Funding for Entrepreneurs

Venture Capital (VC) industry has 4 main entities, which are mentioned below

1. Entrepreneurs who need funding
2. Investors with an objective of securing very high returns.
3. Investment bankers who need companies to sell.
4. Venture Capitalists (VC) who make money for themselves by creating a market for the above 3 players in the industry.

What do you mean by Venture Capital?

Entrepreneurs need investments for their start-up companies. The investments or the capital that these entrepreneurs receive from wealthy investors is called the Venture Capital and the investors are called Venture Capitalists.

VC firms reduce the risk of investments by co-investing with other VC firms. Usually, there will be the main investor called the 'lead investor' and other investors will be called 'followers'.

How does Venture Capital Fund work?

1. Venture Capital Fund is made up of investments from wealthy individuals or companies who give their money to a VC firm to manage their investment portfolios for them and to invest in high-risk start-ups in exchange for equity.
2. The basic idea is to invest in a company's balance sheet and infrastructure.
3. Venture Capitalist nurtures the idea of an entrepreneur for a short period of time and exits with the help of an investment banker.
4. In a start-up company, VC will receive equity partnership in exchange for investments in the start-up company.
5. VC's receive liquidation preference, it means in the worst-case scenario where the company fails, VC's are given the first claim to all the company's assets and technology. It also offers voting rights over key decisions like Initial Public Offer (IPO) or even sale of the company.

What are the types of Venture Capital funding?

As per the ideation stage, age of start-up company and its performance over the years, venture capital funding can be categorised into different types.

Below table gives list of the types of venture capital funding and their features

Type of Funding	**Objective & Amount of Funding**
Pre-seed funding	1. Pre-seed funding is in the range of $100,000 - $200,000 2. Funding provided when a startup is less than a year old. 3. Supports R&D, Market Research. 4. Recruit new members.
Seed Capital	1. Funding will be in the range of $ 1million - $ 2 million 2. Start-up company will need a product that will be viable in the market
Series A funding	1. Funding will range in between $ 2 million - $ 15 million 2. The start-up company needs to have a market-proven product that will help in scaling up fast.
Series B funding	1. Funding can range between $ 7 million - $ 20 million. 2. This round is considered to be less risky. 3. Funding is used for Business Development, advertising.
Series C funding	1. Funds for developing more products and services, acquiring another company 2. Funding received is usually in the range of $ 25 million.
Series D funding	1. Few start-ups reach this stage. 2. Positive reasons could be the company wants to stay private for some more time or they need to go for more expansion before going for IPO. 3. The negative reason could be the company did not hit the expected growth plans. 4. This is down round funding as trust in the companies abilities has been eroded.

Each letter corresponds to the development stage of the start-up that has received funding.

What are the advantages of Venture Capital?

1. Banks usually prefer to finance a new business which has hard assets. In the current information-based economy, new start-ups hardly have any hard asset. Venture Capitalists step in under these circumstances.
2. They can provide more insights into the market.
3. Can help in strategy formulation.
4. Can help in developing strategic networks

How is a Venture Capital (VC) Fund Structured?

Currently, the fund structure is similar to what it was 40 to 50 years back.

1. The partnership is a combination of limited and general partners.
2. The life of the fund ranges from 7 years to 10 years.
3. The VC fund investments take place over the course of the first two to three years and the returns are usually obtained over the last 2 or 3 years.
4. In today's scenario, the average fund managed and the number of investments managed is much more than what it used to be in the past.

Explain the importance of Venture Capital?

Venture Capital industry in the USA is considered as an engine of economic growth. The modern-day computer industry in the USA was created partly due to the capital made available by early venture capitalists like Tom Perkins, Tommy Davis, Eugene Kleiner, Arthur Rock.

How do Venture Capital firms work?

1. Venture capital funds usually go into a particular industry in a particular time period. For example, in the 1980s in the US, Venture Capital (VC) funds majorly went into the energy industry, later on, it shifted into genetic engineering, telecom industry and software companies. In the next stage, VC funds concentrated more on the Internet-based industry.
2. One can safely conclude that VC funding is guided more by the growth potential in a particular industry rather than the potential and skills of individual entrepreneurs.